



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2011 Biennium

Bill #	HB0647	Title:	Provide tax withholding for nonresident sales of Montana real estate
Primary Sponsor:	Barrett, Dick	Status:	As Introduced

- | | | |
|---|--|--|
| <input type="checkbox"/> Significant Local Gov Impact | <input type="checkbox"/> Needs to be included in HB 2 | <input type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>
Expenditures:				
General Fund	\$302,100	\$0	\$0	\$0
Revenue:				
General Fund	\$3,434,719	\$7,863,437	\$7,863,437	\$7,863,437
Net Impact-General Fund Balanc	<u>\$3,132,619</u>	<u>\$7,863,437</u>	<u>\$7,863,437</u>	<u>\$7,863,437</u>

Description of fiscal impact:

This bill would require withholding for income tax purposes on the gain from the sale or exchange of Montana real estate in certain circumstances. Based on information from two DOR projects, the estimated net increase in general fund revenue from this bill is \$3.1 million in FY 2010, increasing to about \$7.9 million in FY 2011- FY 2013.

FISCAL ANALYSIS

Assumptions:

1. This bill would require withholding for income tax purposes on the gain from the sale or exchange of certain Montana real estate; establish a withholding tax rate; provide exceptions to withholding; establish reporting and remittance requirements; require that certain information be submitted with the realty transfer certificate; prohibit the recording of a transfer of Montana real estate or a change in ownership records of Montana real estate for property tax purposes if the required information is not provided; clarify the liability of clerks and recorders and provide rulemaking authority to the Department of Revenue (DOR).
2. In a 2005 study, sales records and data from the property tax database were used to estimate the unreported capital gains from Class 3 (agricultural land) and Class 4 (residential property) sales. For residential property the following work was done:

- a. Records from the property tax database combined with sales history file data revealed 989 properties were sold for at least \$100,000 by non-residents. These sales totaled \$401,843,532.
- b. Based on TY 2003 data, it was found that 70% of non-residents failed to file state tax returns on the gain from sales of class 4 property.
- c. A random sample of 692 recorded sales (70% of the 989 non-resident sales in 2005) was selected. The total sales amount for these 692 recorded sales was \$244,525,855.
- d. Of the 989 total sales in CY 2005, 657 records had a previous sales amount. Based on a review of these 657 sales in calendar year 2005, the most frequent percentage gain was 47%. Multiplying \$244,525,855 by 47% resulted in an estimated \$114,927,152 in unreported capital gains on class 4 sales.
- e. At a 4% tax rate (6% average income tax rate less the 2% capital gains credit), the resulting tax revenue from unreported capital gains on sales of real property was estimated as \$4,597,086 ($\$114,927,152 \times 4\%$).

For class 3 agricultural property the following work was done:

- f. In 2005, there were 2,341 class 3 sales agricultural land sales by non-residents. A per acre value was selected from the appropriate USDA 2005 average value per acre for the particular type of land (farm real estate, cropland, irrigated, non-irrigated, and pasture acreage). Multiplying the number of acres by the appropriate USDA per acre rate resulted in estimated sales of \$148,869,350.
 - g. A randomly selected sample of 1,639 observations was drawn from 2005 agricultural land sales. Based on this sample, it was estimated that for TY 2005, non-residents did not report gains from agricultural land properties totaling \$107,287,457 in sales.
 - h. From 1994-2004, the USDA average increase in the value of farmland was 4.93% per year for a 62% increase over 10 years. This rate was used to estimate unreported capital gains of \$66,518,223 ($\$107,287,457 \times 62\%$) on the agricultural land sales. Applying a 4% tax rate results in unreported tax liability (revenue) of \$2,660,729 ($\$66,518,223 \times 4\%$).
3. Combining the estimated revenue from unreported capital gains from class 3 and class 4 property sales in the assumption above results in \$7,257,815 ($\$4,597,086 + \$2,660,729$) in 2005.
 4. The Office of Federal Housing Enterprise Oversight reports that, from 2005 Q3-2008 Q3, its index of home prices in Montana increased by 22.04%. Data maintained by the Federal Reserve Bank of Kansas City indicates comparable, or greater, land value changes for agricultural farmland over this same time period. Therefore the estimated revenue from unreported capital gains in FY 2008, had this legislation been in place, is \$8,857,437 ($\$7,257,815 \times 1.2204$).
 5. Due to the national recession and the current issues with credit and lending, the real estate market in Montana has slowed down. For purposes of this fiscal note the rate of growth of unreported capital gains for future years is assumed to be flat.
 6. Based on the 2005 study, DOR estimates the bill's proposed withholding and filing requirements will generate an additional \$4.429 million of general fund revenue in FY 2010 and \$8.857 million per year in FY 2011-FY 2013. The lower estimated revenue collected in FY 2010 reflects the fact that the provisions of this bill do not go into effect until September 30, 2009 - the end of the first quarter of FY 2010, and the expected lags in getting any new statewide requirement fully implemented.
 7. In late CY 2007, the DOR began a real estate transaction compliance pilot project to collect additional revenues from unreported real estate transactions. The department compiled data from prior year (2003-2007) Realty Transfer Certificates (RTC) which are filed with DOR for property tax compliance, but not reviewed against income tax data. In the pilot project the prior (2003-2007) RTC data is reviewed to determine if the transaction was potentially taxable and if it had been reported for income tax purposes. Compliance actions are initiated for unreported, potentially taxable transactions. In FY 2008 the RTC pilot project collected an additional \$0.994 million in state audit collections. This additional audit revenue is deducted from the estimated revenue that will be generated over the time period from FY 2010 through FY 2013.

8. The Department estimates the withholding program will require modifications to the Department's tax system, Gentax, costing \$300,000. Additional one-time only operational costs for form development of \$2,100 will be incurred in FY 2010.
9. This bill is effective upon passage and approval. The provisions of the bill apply to transfers of Montana real estate occurring after September 30, 2009.

	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>
<u>Fiscal Impact:</u>				
Department of Revenue				
<u>Expenditures:</u>				
Operating Expenses	\$302,100	\$0	\$0	\$0
<u>Funding of Expenditures:</u>				
General Fund (01)	\$302,100	\$0	\$0	\$0
<u>Revenues:</u>				
General Fund (01)	\$3,434,719	\$7,863,437	\$7,863,437	\$7,863,437
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	\$3,132,619	\$7,863,437	\$7,863,437	\$7,863,437

Sponsor's Initials

Date

Budget Director's Initials

Date